The Washington Post

Tax Pledge Is a Target As Deficits, Debt Grow

Obama Advisers Will Not Rule Out Broad-Based Hike

By Lori Montgomery
Washington Post Staff Writer
Saturday, August 29, 2009

During last year's campaign, President Obama vowed to enact a bold agenda without raising taxes for the middle class, a pledge budget experts viewed with skepticism. Since then, a severe recession, massive deficits and a national debt that is swelling toward a 50-year high have only made his promise harder to keep.

The Obama administration has insisted that the pledge will stand. But the president's top economic advisers have refused to rule out broad-based tax increases to close the yawning gap between federal revenue and government spending and are warning of tough choices ahead.

Republicans are already on the attack, accusing Obama of plotting to break his no-tax vow, the same political transgression that cost Democrats control of Congress under former president Bill Clinton and may have cost president George H.W. Bush his job. Democrats say Obama is highly unlikely to break the pledge before next year's congressional election and observe that it would be safer to wait until his second term if a tax increase becomes unavoidable.

Some lawmakers are focused instead on setting up an independent commission to solve the deficit problem. Senate Budget Committee chairman Kent Conrad (D-N.D.) plans to hold hearings on the topic when Congress returns to Washington this fall.

Obama, meanwhile, has vowed to pay for any new initiatives and to draft an overhaul of the health-care system that eventually would save the government money, driving deficits down. But effective health reforms would take decades to produce savings. In the meantime, White House budget director Peter R. Orszag acknowledged, "there are additional steps that will be necessary."

"The administration is very concerned about these [future] deficits, and getting those deficits under control is a top priority of the administration," Orszag told reporters this week as he rolled out a new economic forecast that added $2 trillion to deficit projections from 2010 to 2019.

Treasury Secretary Timothy F. Geithner and White House economic adviser Lawrence H. Summers have both delicately sidestepped the tax question on Sunday talk shows. Orszag has also refused to discuss what steps Obama might take to reduce the deficit in the budget blueprint he will present to Congress in February. But budget analysts say he has few real options.

"If you rule out inflating our way out of the problem and defaulting on the debt, there are two ways: Cut spending or raise taxes," said William G. Gale, an expert on fiscal policy at the Brookings Institution. With more than 80 percent of federal spending devoted to politically untouchable programs such as Social Security, Medicare and Medicaid, he said, "it's going to be really hard to make significant headway on the spending side. So that means you've got to think about taxes."

Spending cuts were a big part of the solution the last time the nation faced such a towering debt. In the aftermath of World War II, with the debt exceeding the country's entire economic output, the government slashed military expenditures. Within two years, Washington was spending less than it took in. Fifteen percent inflation also helped by reducing the real value of the debt. When the country went to war again in Korea and then Vietnam, tax increases helped keep the budget largely in balance and the debt continued to fall.

Today's problem is more complex. Obama not only faces the fallout from the worst economic downturn in 30 years, but also inherited the debt piled up by his predecessor, Republican George W. Bush. Bush invaded Iraq and approved an expensive new prescription drug benefit for the elderly while pushing through one of the biggest tax cuts of the post-war era -- worth an estimated $1.6 trillion in foregone revenue by the time the provisions expire next year. This was the first time the United States had not adjusted its fiscal policy to meet its wartime needs, according to "The Price of Liberty," a book on war financing by Goldman Sachs vice chairman Robert D. Hormats.

After running surpluses in the late 1990s, the government began spending far more than it took in, forcing the Treasury to increase borrowing from China and other creditors. During the Bush administration, the portion of the debt held by the public jumped from just over $3 trillion to nearly $6 trillion. Federal rescue efforts in the face of last fall's financial meltdown have rapidly driven the debt higher. Today it stands at nearly $7.4 trillion, or about 52 percent of the overall U.S. economy.

"There's no question in my view that Bush was the most fiscally irresponsible president in the history of the republic," said David M. Walker, the comptroller general under Bush who now advocates for deficit reduction. Obama "was handed a bad deck," he said. "But the question is, are you making it better or not? And so far the answer is no."

Obama campaigned on a promise not to raise taxes for anyone earning less than $250,000 a year -- about 97 percent of taxpayers. As part of the pledge, he said he would keep some of the Bush tax cuts, including a new 10 percent rate for the lowest bracket, a higher tax credit for children and a lower penalty for married couples filing jointly. He planned to let other Bush tax cuts that benefit mainly the wealthy expire, a move that would raise rates for the top two income brackets. He also proposed to finance a major expansion of health coverage by placing new tax increases on the rich. When he unveiled his first budget, Obama predicted that his fiscal policies would stabilize the debt at around 70 percent of the economy.

This week, after updating the budget to reflect the depth of the recession, the White House conceded its earlier predictions had been wrong. With unemployment now expected to top 10 percent, the government will be forced to spend more on unemployment benefits, food stamps, Medicaid and other safety-net programs. With wages more deeply depressed, tax collections have fallen further than expected. And with the economy likely to rebound more slowly than the White House once thought, those costly conditions will linger for at least the next two years.

The result: deficits of well over $1 trillion through 2011, which will push the debt to 71 percent of the economy by the end of Obama's first term -- the highest since 1954 -- and cause the debt to keep rising in the years beyond.

The sour economy also will increase the cost of some of Obama's initiatives. The economic stimulus package approved in February is likely to cost "tens of billions of dollars" more than $787 billion, Orszag said. Obama's plan to expand federal student loans will cost $27 billion more over the next decade "as more individuals choose to go to college in the weakened labor market," White House budget documents say. And tax increases for the wealthy won't bring in quite as much money as Obama had hoped, budget documents say, because even the wealthy are not earning as much.

Obama could try to cut spending, but his budget is probably already more frugal than politics will bear, budget analysts say. For example, the White House assumes that spending on federal agencies other than the Pentagon will be lower in 2019 than it is next year.

And the fastest-growing budget category is one Obama cannot touch: interest payments on the debt. These are likely to rise as the world demands higher interest rates in return for continuing to sate Washington's voracious appetite for credit. The White House projects interest payments will quadruple by 2019, when debt service will account for nearly the entire budget deficit. At that point, much like a family that has run up big credit card balances, the debt will continue to grow even if the nation all but stops borrowing money.

"We are entering a dangerous debt cycle," said Maya MacGuineas, president of the bipartisan Committee for a Responsible Federal Budget. "We don't know when interest rates will go up, but when they do, you can see that they will have a huge impact."

By contrast, Obama could raise taxes without taking any legislative action. If he let all the Bush tax cuts expire next year and refused to enact legislation to restrain the alternative minimum tax, deficits would be about $200 billion a year lower and the debt would stop growing as a percentage of the economy, according to Gale's analysis of new data from the nonpartisan Congressional Budget Office. But that would mean big tax increases for most American families, violating Obama's pledge.

Whatever course Obama takes, Geithner said earlier this month that the economy cannot fully recover until deficits are brought under control.

"We have to bring these deficits down very dramatically," Geithner told ABC News. "And that's going to require some very hard choices."